



## **Linking Military Compensation to Retention**

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## One Congressional Concern

Will the recruiting and retention problems of 2005 be repeated:

- As the economy improves?
- With the surge in Afghanistan?



## Congress Authorizes

- Basic pay increase,
  - 3.4% for 2010, 0.5% above ECI
- Payment of selected reenlistment and other retention bonuses
  - Congress appropriates total funding
  - Rates of pay per service member set by law for some other special and incentive pays (sea pay, family separation)
- Retirement, education benefits, medical benefits to non-active-duty
  - Jurisdiction split among various committees
  - DOD may have statutory authority under current law but Congress may override (e.g. TRICARE cost sharing)



## Indicators of the Adequacy of Pay as a Retention Tool

- Military-civilian comparisons
  - Military-civilian pay gap
    - Comparing cumulative increases over time in civilian wages to military basic pay
    - Easy to compute
    - Narrow measure of earnings
    - May not reflect retention over the longer term
  - Levels of military and civilian pay, adjusted for education and experience
    - Who is in the comparison group
    - May not reflect retention problems
- Retention problems
  - Related to many factors
    - Economy, deployments, work and living conditions
  - Actions of Congress may lag substantially



## Estimates of Military Compensation

- Average compensation per service member between \$100,000 and \$150,000
  - Estimates based on data from 2000 through 2006 and may be higher at present time
- Cash earnings total 40% to 50% of compensation
  - Basic pay, allowances, special pays and tax advantage
  - Basic pay averages about 55% to 60% of RMC
  - Special pays are about 5% of the military personnel account
- Noncash and deferred cash compensation comprise remainder
  - Base-provided services, retirement pay, health care benefits, educational benefits
  - Majority of which are deferred benefits



## Effectiveness of Cash Pay

- Across-the-board increases in pay
  - May be appropriate when widespread difficulties in manning
  - 1% increase in pay: retention increases 0.5% to 2.0%
- Targeted pay (reenlistment bonus)
  - When manning shortages are experienced only within selected occupational fields
  - SRBs are more cost-effective if targeted to occupations
    - With higher responsiveness (higher elasticities)
    - Where retention is relatively low
  - One level SRB: reenlistment increases 1 to 3 ppt



## Manning Shortfalls

- Many enlisted occupations are chronically under- or over-staffed
  - 30% regularly had manning shortfalls from 2000 to 2007
  - 40% were overstaffed during that time
- Variation in pay is relatively small compared to the civilian sector
  - Bonuses are a small part of compensation



## CBO Budget Option

- Proposal
  - Increase basic pay by ECI minus 0.5% for 2010 through 2014
  - Target additional compensation to occupations with manning shortfalls in those years
- Impact for the Army
  - Reenlistments drop about 300 to 350 soldiers, compared to total reenlistments of about 65,000
  - One level SRB to  $\frac{1}{4}$  of the first-term soldiers in targeted occupations buys that back and saves money immediately
- Impact service-wide
  - Retention held constant
  - Multi-year savings could be several billion



## Considerations for a Shift to Bonuses

- Flexibility
  - Bonuses can be more easily adjusted year to year to match retention goals
  - Bonuses can be focused on the years of service when service members make career decisions
- Equity
  - Should all service members receive similar pay because they're all warfighters first?
  - Or, should military pay be more closely aligned with civilian alternatives?
- Lower overall compensation than otherwise in out-years
  - Bonuses do not compound the same way as do increases in basic pay
  - Shift to bonuses reduces retirement pay and other benefits



## Not All Compensation Is Equal

- Noncash compensation
  - May be offered because it can be provided more cheaply than buying it in the individual market
  - Promotes military readiness and ensures quality of life
  - May be less effective than cash as a retention tool
    - Restricts choices of service members
    - Service members may not value a military-provided service as much as it costs to provide
- Deferred benefits
  - Many service members will never be eligible for some of the deferred benefits
    - Only 15% of enlisted personnel stay to retirement
  - Younger service members attach little value to the benefit
    - High discount rate



## Some Compensation May Suppress Retention

- Educational benefits for veterans
  - Have to separate from active duty to use it intensively
  - Research suggests that a \$10,000 boost in benefits increases separations up to 3 percentage points
- Cliff-vesting of retirement pay
  - Roughly one-quarter of service members who serve 19 years stay through 24 years
  - Early retention effects are positive but small, although it provides incentives for higher seniority service members to stay
    - DoD contributes, on average, more than \$8,000 per year to the Military Retirement Fund; service members at first-reenlistment value the entire benefit at about \$8,000